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Attorney and Client -- Dealing with Clients' Property -- the ABA Revision of Canon Eleven

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logically have formed the basis of the Court's decision. Thus, had Justice Black not chosen to embark on a tortuous linguistic search for "power," he might well have found the answer to the foreclosure issue by asking three simple questions: Did the defendant's questionable conduct result in any sales within the prefabricated home market? If so, were there enough of these sales to make the defendant's competitors in that market seek to establish a similar mode of conduct? Finally, was that mode of conduct unavailable to these competitors? An affirmative answer to these questions would establish foreclosure; if the defendant were unable to provide some overriding justification, the balance could be logically struck against him, and his conduct declared unlawful.

KENNETH B. HIPPI

Attorney and Client—Dealing with Clients' Property—the ABA Revision of Canon Eleven

Historically, the attorney-client relationship has been one of delicate trust, as observed by Justice Nelson in 1850:

There are few of the business relations of life involving a higher trust and confidence than that of attorney and client, or, generally speaking, one more honorably and faithfully discharged; few more anxiously guarded by the law, or governed by sterner principles of morality and justice; and it is the duty of the court to administer them in a corresponding spirit. . . .¹

A recent Iowa case, *Nadler v. Treptow*,² illustrates the ethical questions arising when an attorney becomes interested in his client's property. Attorney Nadler represented Elsie Treptow in, among other matters, a contract for the purchase of real property from the estate of one Pappas. Financial difficulties prevented Mrs. Treptow's meeting her three-hundred-dollar-per-month contractual obligation to the estate. Because the "problem was complicated,"³ Nadler was able to purchase from the Pappas estate at an eight-hundred-dollar reduction the interest that his client had sought. At least one complication of which the court spoke was the prior contract with Mrs. Treptow. Through it, presumably, Nadler learned of the factors that caused the reduction in price: The attorney-client relationship became one of debtor-creditor/contract vendor.⁴ Nadler

¹ *Stockton v. Ford*, 52 U.S. 232, 247 (1850).

² — *Iowa* —, 166 N.W.2d 103 (1969).

³ *Id.* at —, 166 N.W.2d at 108 (dissenting opinion).

⁴ *Id.*

then brought an action against his client for his full fee; she defended by asserting a breach of the fiduciary duty stemming from the lawyer-client relationship. The trial court found that the attorney's purchase was not against the interest of his client⁵ and granted him recovery of one thousand dollars, which was fifty-four per cent of the fee sought. A majority of the Supreme Court of Iowa affirmed, commenting, "[w]e cannot say that the [trial] court's findings and conclusions were without support in the evidence."⁶

Four members of the court disagreed: "Both the municipal court and the majority opinion completely ignore the fiduciary relationship of this plaintiff to defendant, his client."⁷ The dissent would have applied Canon Eleven of the American Bar Association's *Canons of Professional Ethics*, which provides:

Dealing with Trust Property. The lawyer should refrain from any action whereby for his own personal benefit or gain he abuses or takes advantage of the confidence reposed in him by his client.⁸

The basic policy underlying the dissent in *Nadler* as well as Canon Eleven is that once the client's confidence is reposed in his attorney, the latter should not be able to use it to his client's detriment or prejudice.⁹ Otherwise stated,

In America, where the stability of the courts and of all departments of government rests upon the approval of the people, it is peculiarly essential that the system for establishing and dispensing justice be . . . so maintained that the public shall have absolute confidence in the integrity and impartiality of its administration. . . . It cannot be so maintained unless the conduct and motives of [the men] of our profession are such as to merit the approval of all just men.¹⁰

The American Bar Association Standing Committee on Professional Ethics has stated that generally it is improper for an attorney to purchase

⁵ *Id.* at —, 166 N.W.2d at 104.

⁶ *Id.* at —, 166 N.W.2d at 105.

⁷ *Id.* at —, 166 N.W.2d at 106 (dissenting opinion).

⁸ ABA CANONS OF PROFESSIONAL ETHICS No. 11. The Supreme Court of Iowa has adopted the ABA Canons, with the exception of a portion of Canon 27. IOWA CODE ANN., appendix to § 610, rule 119 (Supp. 1969). Prior to August, 1969, forty-one states and the District of Columbia had adopted the ABA Canons. Letter from Frederick R. Franklin, ABA Staff Director for Professional Standards, to J. Michael Brown, November 13, 1969 [hereinafter cited as Franklin Letter].

⁹ *Stockton v. Ford*, 52 U.S. 232, 247 (1850).

¹⁰ *Preamble* to ABA CANONS OF PROFESSIONAL ETHICS.

assets from an estate that he is representing.¹¹ The New York City Bar Committee has commented that the entire area of an attorney's dealing in his client's property is "fraught with danger."¹² Suspension of the attorney by a state bar association for breach of the fiduciary duty has been upheld in several instances.¹³

The practical application of Canon Eleven often places stringent requirements on the attorney. Courts are particularly inquiring when an attorney purports to represent a client and then takes title to property in his own name.¹⁴ The purchase of a client's property has been allowed in several cases in which no confidence was breached and the attorney-client relationship had ended.¹⁵ But courts have invoked the fiduciary relationship in patent infringement suits by clients against their attorneys,¹⁶ and attorneys have been denied the right to purchase a client's real property at a foreclosure sale¹⁷ or from an estate.¹⁸ The protection extends to corporate clients;¹⁹ an attorney may not purchase interests adverse to those of the corporation he represents.²⁰ Courts have likewise unmasked the subterfuge of third-party purchases for the attorney's benefit.²¹

Transactions between attorney and client, if disputed, have been considered *prima facie* fraudulent and invalid.²² Recurrently, a presumption

¹¹ ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 667 (1963); *accord*, *id.* No. 250 (1943).

¹² WILLIAM NELSON CROMWELL FOUNDATION, OPINIONS OF THE COMMITTEES ON PROFESSIONAL ETHICS OF THE BAR OF THE CITY OF NEW YORK AND THE NEW YORK COUNTY LAWYERS' ASSOCIATION 291 (1956).

¹³ *Lowe v. State Bar*, 40 Cal. 2d 564, 254 P.2d 506 (1953); *Sunderlin v. State Bar*, 33 Cal. 2d 785, 205 P.2d 382 (1949); *In re Sandblast*, 210 Ore. 65, 307 P.2d 532 (1957).

¹⁴ *Mebane v. Broadnax*, 183 N.C. 333, 111 S.E. 627 (1922).

¹⁵ *Waters v. Bruner*, 355 S.W.2d 230 (Tex. 1962); *Minchen v. Arment*, 266 S.W.2d 257 (Tex. Civ. App. 1954).

¹⁶ *Reush v. Fischer*, 49 F.2d 818 (C.C.P.A. 1931); *Goodrum v. Clement*, 277 F. 586 (D.C. Cir. 1921); *Bumgardner v. Hudson*, 277 F. 552 (D.C. Cir. 1921).

¹⁷ *Gaffney v. Harmon*, 405 Ill. 273, 90 N.E.2d 785 (1950); *Vrooman v. Hawbaker*, 377 Ill. 428, 56 N.E.2d 623 (1944); *Carson v. Fogg*, 34 Wash. 444, 76 P. 112 (1904). *Contra*, *Kelly v. Weir*, 243 F. Supp. 588 (E. D. Ark. 1965). In this case an attorney was allowed to purchase his client's real estate at a foreclosure sale that commenced when the client, against the advice of the attorney, repeatedly refused to comply with the Agricultural Adjustment Act of 1938, which limited crop production per acre and gave the government the right to foreclose for non-compliance with the Act.

¹⁸ *Healy v. Gray*, 184 Iowa 111, 168 N.W. 222 (1918); *Deal v. Migoski*, 122 So. 2d 415 (Fla. 1960); *In re Sandblast*, 210 Ore. 65, 307 P.2d 532 (1957).

¹⁹ *Oil, Inc. v. Martin*, 381 Ill. 11, 44 N.E.2d 596 (1942).

²⁰ *Sea Cove Marina, Inc. v. Uhlendorf*, 18 App. Div. 2d 1021, 239 N.Y.S.2d 29, *aff'd*, 15 N.Y.2d 714, 204 N.E.2d 499, 256 N.Y.S.2d 340 (1965).

²¹ *Demmel v. Hammett*, 360 Mo. 737, 230 S.W.2d 686 (1950); *Gragg v. Pruitt*, 179 Okla. 369, 65 P.2d 994 (1936).

²² *See, e.g., Baker v. Otto*, 180 Md. 53, 55, 22 A.2d 924, 925 (1941).

of fraud arises,²³ and the burden is on the attorney to show that no advantage has been taken.²⁴ The transaction may be saved only if the attorney has fully informed his client of his intentions²⁵ and obtained his consent,²⁶ and if adequate consideration supports the exchange of property.²⁷ One court has gone as far as to say that without consent the transaction "is vitiated by the law, irrespective of its merits, fairness, or good faith."²⁸

Although the dissent in *Nadler* pointed out that "[n]ot once did plaintiff clearly show just when and under what circumstances he advised defendant he was going to become her creditor-contract vendor,"²⁹ the trial court found as a fact that full disclosure was made and that the purchase could actually be to her benefit.³⁰ The supreme court recognized that disclosure to the client was required and affirmed the trial court's findings, but neglected in its discussion to detail just how Nadler met the standard. Nadler, therefore, received lenient treatment by the majority: He was not required to show affirmatively either his disclosure or the lack of harm to his client; it is uncertain whether he in fact completely revealed his interest in the property to Mrs. Treptow,³¹ and he concededly did not pay adequate consideration.

If Nadler's conduct violated or was at least questionable under the ethical standards of his profession, what was the appropriate remedy? The procedural setting complicates this question, for Mrs. Treptow first complained of her attorney's ethics when he sued her for his fee. One remedy could have been a declaration by the court that the property be held in a constructive trust in favor of the client, as illustrated in *Healy v. Gray*.³² Gray, an attorney, represented Healy to secure his appoint-

²³ *Lawrence v. Tschirgi*, 244 Iowa 386, 57 N.W.2d 46 (1953); *Reeder v. Lund*, 213 Iowa 300, 236 N.W. 40 (1931); *Baird v. Laycock*, 94 S.W.2d 1185 (Tex. Civ. App. 1936).

²⁴ *Swaim v. Martin*, 158 Ark. 469, 251 S.W. 26 (1923); G. WARVELLE, *ESSAYS IN LEGAL ETHICS* 155-56 (2d ed. 1920).

²⁵ *Allison v. Caruthers*, 205 Okla. 582, 239 P.2d 759 (1952).

²⁶ *Demmel v. Hammett*, 360 Mo. 737, 230 S.W.2d 686 (1950); *In re Sandblast*, 210 Ore. 65, 307 P.2d 532 (1957).

²⁷ "It is essential that the sale should be at a price which is fair and reasonable." *Littleton v. Kincaid*, 179 F.2d 848, 858 (4th Cir. 1950); see *Deal v. Migowski*, 122 So. 2d 415 (Fla. 1960).

²⁸ *Gragg v. Pruitt*, 179 Okla. 369, 372, 65 P.2d 994, 997 (1936).

²⁹ ——— Iowa at ———, 166 N.W.2d at 108 (dissenting opinion).

³⁰ *Id.* at ———, 166 N.W.2d at 104.

³¹ The majority (*id.* at ———, 166 N.W.2d at 104) and the dissent (*id.* at ———, 166 N.W.2d at 108) disagreed on this point.

³² 184 Iowa 111, 168 N.W. 222 (1918).

ment as executor of his father's estate. As a result of this attorney-client relationship, Gray became aware of and purchased property, which had first been offered to his client, at five-hundred sixty dollars below the market price. The court declared a constructive trust in favor of the client. Arguably, had Mrs. Treptow pursued this course of action, she might have prevailed as did the plaintiff in *Healy*; however, she sought only to deny Nadler his fee.

Perhaps the best deterrent to questionable conduct is to deny the attorney compensation. Courts in various situations have followed the maxim that "[a]n attorney's right to compensation may be defeated by fraud or misconduct on his part."³³ In *Donaldson v. Eaton & Estes*³⁴ the plaintiff was allowed to reclaim a large part of an attorney's fee that the court determined to be in excess of just compensation. The court stated that "[a]n attorney who acts in bad faith and seeks to secure his personal advantage to the prejudice of his client may properly be denied compensation for his services."³⁵ Perhaps the majority in *Nadler* invented its own solution, the fifty-four per cent recovery being its Solomonic estimate of just compensation.³⁶

The entire realm of legal ethics, including the attorney-client relationship, was re-examined by the American Bar Association at the 1969 Dallas Convention; and the existing canons were revised into a new *Code of Professional Responsibility*.³⁷ The Special Committee on Evaluation of Ethical Standards noted four dissatisfactions with the old Canons: (1) incomplete coverage of attorney misconduct; (2) a need for editorial revision; (3) a lack of practical sanctions; and (4) modern social changes

³³ 7 C.J.S. *Attorney and Client* § 167(c) (1937). See, e.g., *Shelton v. Gwathemy*, 201 Misc. 75, 107 N.Y.S.2d 653 (Sup. Ct. 1951); *Duffy v. Colonial Trust Co.*, 287 Pa. 348, 135 A. 204 (1926); *Royden v. Ardoin*, 160 Tex. 342, 331 S.W.2d 206 (1960).

³⁴ 136 Iowa 650, 114 N.W. 19 (1907).

³⁵ *Id.* at 656, 114 N.W. at 21.

³⁶ The trial court gave great weight to testimony that Nadler told Mrs. Treptow that she owed him one-thousand dollars. — Iowa at —, 166 N.W.2d at 105.

³⁷ The new Code will become effective only if courts and bar associations in individual states choose to adopt it. The Franklin Letter, *supra* note 8, states:

As for the Code of Professional Responsibility, our information is that to date the bar associations of Arkansas, Vermont, and New York have adopted the Code. However, it is actively being considered by numerous other states and, as noted in the attachment, several states [Arizona, Nevada, New Mexico, Pennsylvania, South Dakota, Wisconsin, and perhaps Kentucky] automatically adopt the rules of ethics of the American Bar Association as they are promulgated from time to time. Therefore, on January 1, 1970, the date on which the Code of Professional Responsibility will become effective for ABA members, the Code will automatically go into effect in those states.

demanding re-evaluation of ethical standards.³⁸ A totally new format evolved, embodying three levels of rules with varying degrees of specificity. First are the nine "Canons," intended as "statements of axiomatic norms [or] . . . general concepts."³⁹ The "Ethical Considerations" applicable to each Canon attempt to offer more specific guidance. Finally, the "Disciplinary Rules" provide a "minimum level of conduct below which no lawyer can fall without being subject to disciplinary action,"⁴⁰ although no specific procedures and penalties are prescribed.⁴¹

What has become of the old Canon Eleven under the new Code? It now exists as Canon Four,⁴² Ethical Consideration 4-5,⁴³ and Disciplinary Rule 4-101 (B).⁴⁴ Ethical Consideration 4-5 creates two categories of violations, use of confidential information to the disadvantage of the client, which is expressly forbidden, and use to the advantage of the attorney, permitted only if the client consents after a full disclosure. Disciplinary Rule 4-101 (B) includes the traditional mandates of consent and disclosure,⁴⁵ but any requirement of full consideration is omitted.⁴⁶

Concerning exchanges of information that must be kept secret, the Ethical Consideration in point is conveniently vague. It refers only to

³⁸ *Preface* to ABA CODE OF PROFESSIONAL RESPONSIBILITY at v (Final Draft, July 1, 1969) [hereinafter cited as CODE].

³⁹ Preliminary Statement to CODE at 2.

⁴⁰ *Id.*

⁴¹ "The code makes no attempt to prescribe either disciplinary procedures or penalties for violation . . ." *Id.*

⁴² Canon Four provides: A Lawyer Should Preserve the Confidences and Secrets of a Client.

⁴³ Ethical Consideration 4-5 provides:

A lawyer should not use information acquired in the course of the representation of a client to the disadvantage of the client and a lawyer should not use, except with the consent of his client after a full disclosure, such information for his own purposes. Likewise, a lawyer should be diligent in his efforts to prevent the misuse of such information by his employees and associates

⁴⁴ Disciplinary Rule 4-101 (B) provides:

Except as permitted by DR 4-101 (C), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client.

(2) Use a confidence or secret of his client to the disadvantage of the client.

(3) Use a confidence or secret of his client for the advantage of himself or of a third person, unless the client consents after a full disclosure.

Disciplinary Rule 4-101 (C) deals only with minor exceptions to part (1) of the above.

⁴⁵ CODE, Disciplinary Rule 4-101 (B) (3).

⁴⁶ A plausible explanation is that the Code does not deal specifically with the purchase of a client's property. Instead, the Code limits generally the use of a confidence or secret.

"information acquired during the course of representation. . . ."⁴⁷ The Disciplinary Rules are more descriptive: They establish two categories of information, confidences and secrets, that may not be misused or revealed. A "confidence" is defined as "information protected by the attorney-client privilege under applicable law."⁴⁸ One writer sets forth the general law of privilege as follows:

It is the essence of the [attorney-client] privilege that it is limited to those communications as to which the client either expressly made confidential or which he could reasonably assume under the circumstances would be understood by the attorney as so intended.

. . . .

A mere showing that the communication was from client to attorney does not suffice, but the circumstances indicating the intention of secrecy must appear.⁴⁹

On the other hand, a "secret" refers to "information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client."⁵⁰

Thus it appears that the definitions of "confidence" and "secret" both require an intent on the part of the client that the communication remain confidential. Would the situation in *Nadler* have fit either definition? Probably not. It is unlikely that Mrs. Treptow would have been concerned that her purchase agreement with the Pappas estate remain strictly confidential; the agreement may even have been general knowledge in the community.

Apparently adding some form of *mens rea* to the elements of an attorney's misconduct, Disciplinary Rule 4-101 (B) prohibits a lawyer from "knowingly" abusing his client's confidence. Perhaps this rather perplexing requirement was included to protect a lawyer in those unusual instances in which he unknowingly transmits confidential information to a third party, has no reason to believe that use of the information will disadvantage his client, or is unaware that such information is a "confidence" or "secret" within the definition. This third possibility is most unlikely, in that it would be arguable that if *Nadler* did not know that the information he received was a "confidence" or "secret," he could not have violated the Code. Such a rule makes ignorance of the law a

⁴⁷ CODE, Ethical Consideration 4-5.

⁴⁸ *Id.*, Disciplinary Rule 4-101 (A).

⁴⁹ C. McCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 95, at 190-91 (1954).

⁵⁰ CODE, Disciplinary Rule 4-101 (A).

permissible defense, and such an interpretation of the Code was probably unintended since an even stricter standard is normally required of attorneys than of others. The rule should be more explicit in its use of the word "knowingly."

Why did the justices in *Nadler* believe that the attorney's conduct was unethical? Mrs. Treptow was not harmed; she was financially unable to complete her purchase of the property in any event.⁵¹ The answer is that such conduct causes injury to the integrity of the legal profession and judicial system. The essence of the fiduciary relationship is the trust and confidence a client places in his attorney. Such trust must be protected by the law, or the effectiveness of the judicial system declines. Given his unique access to information regarding a client's property, an attorney should not be allowed to use such information to his own advantage—if for no other reasons than basic notions of fairness and equity. If, as occurred in *Nadler*, the lawyer becomes his client's creditor, he can hardly be expected to conduct the client's affairs with the objective zeal demanded of the advocate—the lawyer's own pecuniary interests become bound with those of his client.

In summary, the American Bar Association recently has clarified and strengthened the fiduciary duties of the attorney wishing to deal in his client's property. Unfortunately, the revision of the ABA Canons probably would not aid a court in dealing effectively with the situation before the Iowa court in *Nadler*. The concept of breach of a fiduciary duty owed by an attorney to his client, however, should be used by courts in the future. Such a court-formed doctrine could be developed as a basis for allowing a defense seeking reduction or disallowance of an attorney's fee. Instead of passing lightly over the acts required for fulfillment of the attorney's fiduciary duty, the Iowa court in *Nadler* should have established an explicit precedent in fiduciary misconduct by penalizing the lawyer financially.

J. MICHAEL BROWN

Constitutional Law—First Amendment Rights— Flag-Burning As Symbolic Expression

In a period when the first amendment's¹ protection of the individual from governmental power is being challenged by new and bizarre methods

⁵¹ — Iowa at —, 166 N.W.2d at 104.

¹ The first amendment binds the states through the fourteenth amendment. *Stromberg v. California*, 283 U.S. 359 (1931).